December 16, 2019 | Marketing Material

From TINA to FOMO

Increasingly, "fear of missing out" has joined "there is no alternative" as a key argument for equities.

_ Overall, we remain constructive on equities.

_ We expect growth of around 4–7% in earnings per share for most regions in 2020 and beyond.

_ However, there are good reasons to be vigilant, among them the upcoming U.S. elections in 2020.

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What happens after a mid-cycle slow down? Once again, the most likely answer in the current extended cycle appears to be "yet another moderate upswing." In 2020, we expect about 5% in total returns for global equities. And lest that sounds disappointing, remember how pessimistic many investors were only three months ago and how strongly markets have performed in the last 12 months. For example, we expect Germany's Dax to reach 14,000 by December 2020. At Christmas time 2018, it was trading at just under 10,300 points.

Nor is the Dax all that unusual. Given its heavy weighting towards manufacturing, it just illustrates some of the trends we have seen in 2019 particularly well. While the global economy has avoided contraction, several industries have entered recessionary territory in 2019 with shrinking revenues and profits. These include the global auto industry, U.S. railways and global transportation, the energy sector as well as many European banks and semiconductors. The weakness was partly driven by sector- and company-specific factors. Car makers, for example, suffered from technological transition risks as manufacturers embarked on aggressive investment in electronic vehicles. Eurozone banks were hit by negative interest rates, while a lower oil price hurt fossil-energy companies. By far the biggest drag was persistent political uncertainty, notably due to trade tensions and Brexit.

As the market focus shifted towards 2020, the mood turned more constructive on equities. On some hot political topics, markets have increasingly come around to our view that worst-case outcomes will be avoided. On Brexit, for example, we argued during the summer that a chaotic, "No-Deal" exit was fairly unlikely. That is still our thinking, despite the uncertain outcome of the UK snap general election in December.

Most importantly, the prospects of a de-escalation in the U.S.-Chinese trade conflict have probably improved, as President Trump switches into re-election mode. We would caution against strong calls this far ahead of Election Day on November 3, 2020. As a purely statistical matter, there is plenty of uncertainty under the Electoral-College system of picking a president. While the Electoral College favored Trump in 2016, for example, it also favored Democratic candidates in 2012 and 2004. We think that the most likely outcomes are either a Trump re-election or one of the more moderate Democratic candidates succeeding him. Both outcomes would probably have a limited impact on the U.S. equity market overall. Whoever wins might well be constrained by the opposing party retaining control of at least part of Congress. (Currently, Democrats control the House, while Republicans control the Senate.)

Rather than getting distracted by political noises, it might therefore be better to focus on economic fundamentals. In our view, healthy labor markets and continued growth in the "digital economy" should stabilize growth in the coming months. Pent-up demand from delayed investment decisions and easier year-on-year comparisons should modestly accelerate profits in the second half of 2020. In Europe, a resolution of the Brexit drama might also help. A longer-term trend is that companies are adapting to the digitalization of their business processes and the secular prospects of a low-growth economy.

Overall, we expect growth in earnings per share (EPS) to rebound to around 4-7% for most regions in 2020 and beyond. While our earnings-growth assumptions are below consensus (except for Japan), we forecast an acceleration relative to 2019. We assume little additional support from central banks in 2020, as both the U.S. Federal Reserve and the European Central Bank appear done in cutting interest rates for now. However, low interest rates should keep valuation multiples above historical levels. Dividends above bond yields add to the attractiveness of equities. As a result, our S&P 500 target of 3,200 for December 2020 assumes a rich 18.8x trailing price-to-earnings ratio. Receding recession risks have allowed us to lift the target multiples, in particular for the more cyclical markets, including Germany, Japan and some of the bigger emerging markets.

Of course, U.S. trade policy has the potential to move equity markets away from our central scenario in either direction. Our base case assumes no further tariff hikes. Changing expectations for the outcome of the U.S. election could re-introduce volatility to equities as early as in the first quarter of 2020, when the primaries for the Democratic nomination start. For now, the contest looks wide open, and we expect that whoever wins might well pivot towards the center for the general election in November. That said, we would expect clear downside for global equities in the (in our view unlikely) case of a policy shift towards left-wing populism among leading Democrats in the races of the White House and Congress.

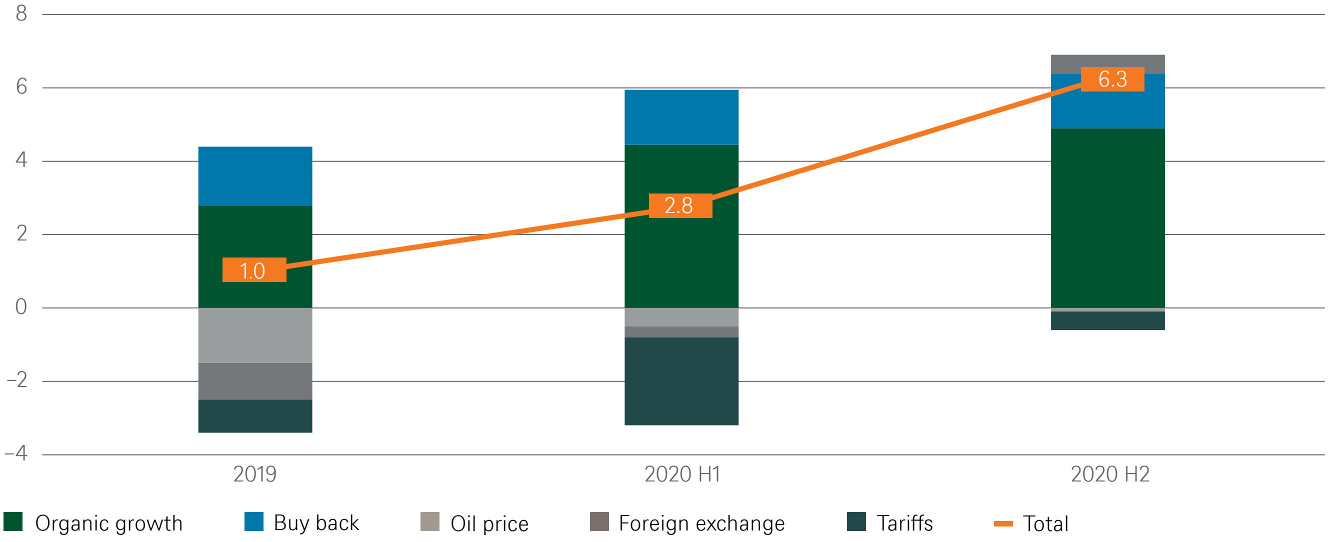
At this stage, we refrain from expressing a strong regional preference for 2020. Evidence of the global economy accelerating would probably boost non-U.S. markets the most. During the past three years, equity markets have mainly been driven by "growth" stocks, with little contribution from "value" stocks. We believe that the valuation spread between the two styles has peaked. In order to benefit from an improving economic environment, we prefer a balanced style positioning for 2020. "Value" outperformance would require a meaningful economic re-acceleration and rising interest rates, none of which is predicted in our base case. The balanced style view is also reflected in our recent upgrade of industrials ("value") to neutral, and our overweights in information technology ("growth") and financials ("value"). Other market segments we like include: U.S. media within communication; integrated oil within energy, U.S. banks within financials; beverages and tobacco within staples; medtech within health care.

Which takes us to one last message to end the year and this outlook with. 2020 might well prove another good year. Indeed, we might even raise our index targets, if the macroeconomic environment remains benign and interest rates stay low. However, 2020 might also mark the start of a difficult decade in equity markets. As we argued back in September, "there may be few alternatives to equities. However, that is no longer a sufficient reason to buy into every dip." Increasingly, "there is no alternative," or TINA, has been joined by "fear of missing out," or FOMO. Along with light investor positioning and other technical reasons, both TINA and FOMO augur well for the next few weeks and months and maybe even longer if the overall environment remains benign. There is no guarantee, however, that the good times will last. Put differently, markets may only be one bellicose trade-war tweet away from the next nerve-racking correction. How to best react will depend on longer-term economic fundamentals, unclouded by both TINA and FOMO.

ORGANIC PROFIT GROWTH LOOKS SET TO REBOUND IN 2020

After a difficult year, we expect growth in U.S. corporate profits to resume, especially, when the drag from tariffs should begin to diminish in the second half of 2020.

S&P 500: EPS-growth components; estimated year-on-year growth in %

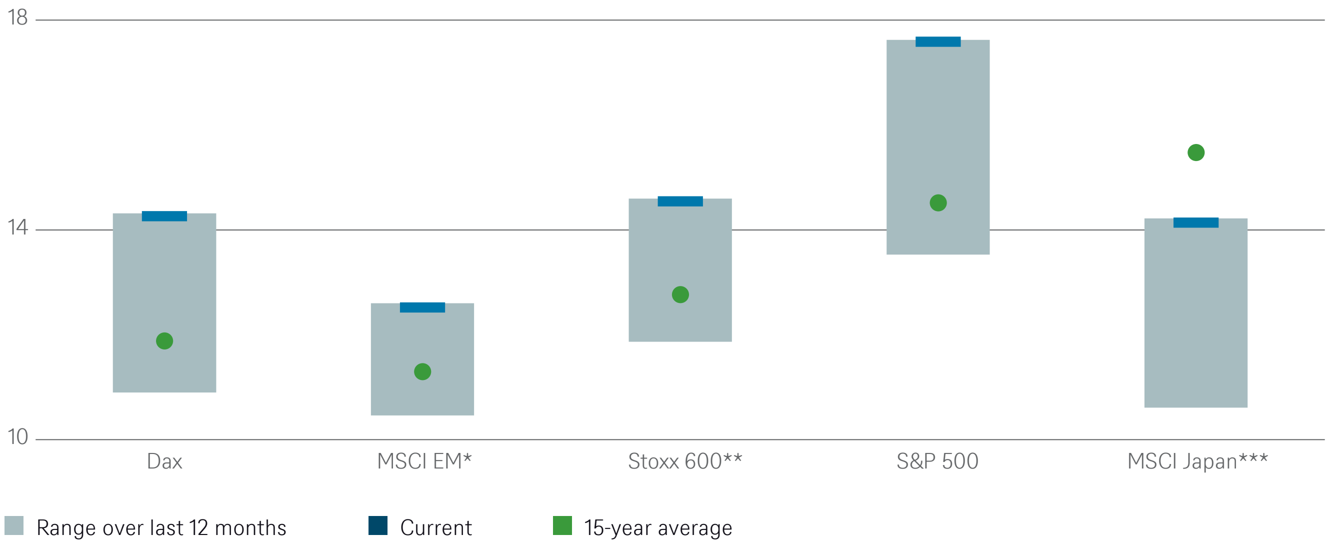


Sources: Bloomberg Finance L.P. , DWS Investment GmbH estimates as of 11/2019

EQUITY VALUATIONS LOOK JUSTIFIABLY ELEVATED

In most markets, current price-to-earnings ratios are above long-run averages. That partly reflects low interest rates and a lack of alternatives.

Price-to-earnings ratio, based on 12-months-forward earnings



* MSCI Emerging Markets Index; ** Stoxx Europe 600; *** MSCI Japan Index
Sources: Bloomberg Finance L.P. as of 11/2019

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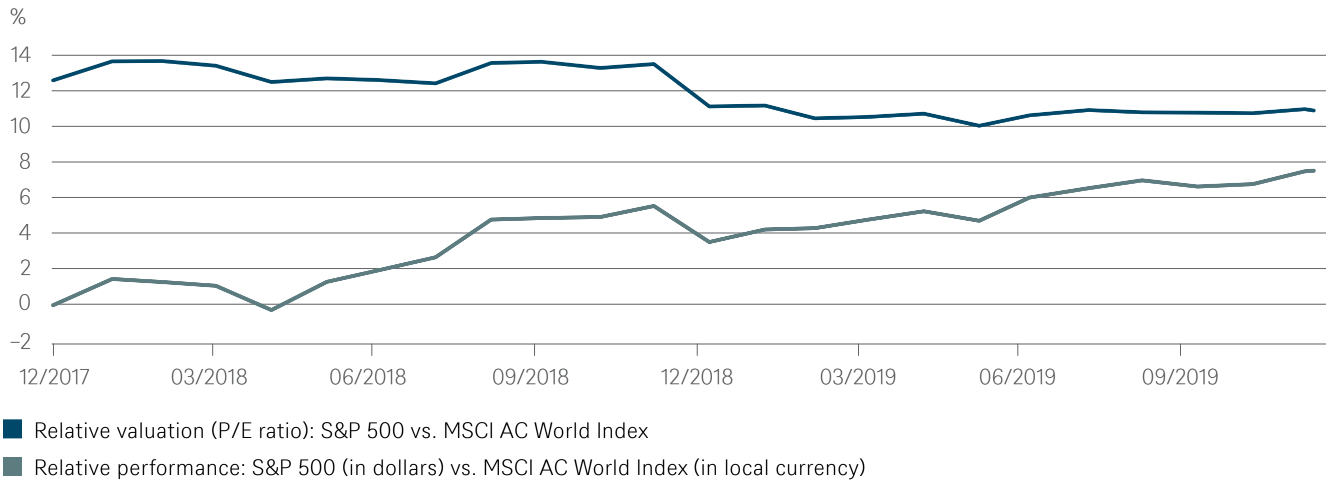
DWS Investment GmbH

Valuations overview

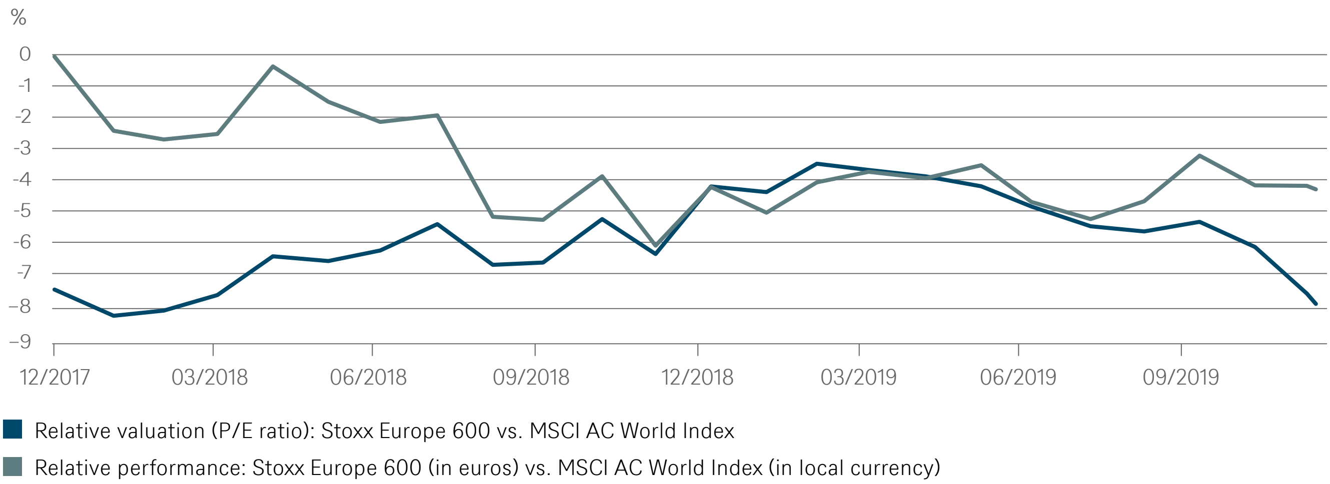
UNITED STATES: NEUTRAL (NEUTRAL)*

The U.S. economy continues to churn out pretty solid numbers. We are increasingly confident that the corporate sector will see a rebound in organic earnings growth in 2020. Buybacks should continue to be helpful as well. Politics remain a risk. Renewed trade tensions or further signs of one of the more left-wing Democratic candidates gaining traction could rattle markets. And, for the longer term, we are somewhat concerned about the quality of reported earnings this late in the business cycle.



EUROPE: NEUTRAL (NEUTRAL)*

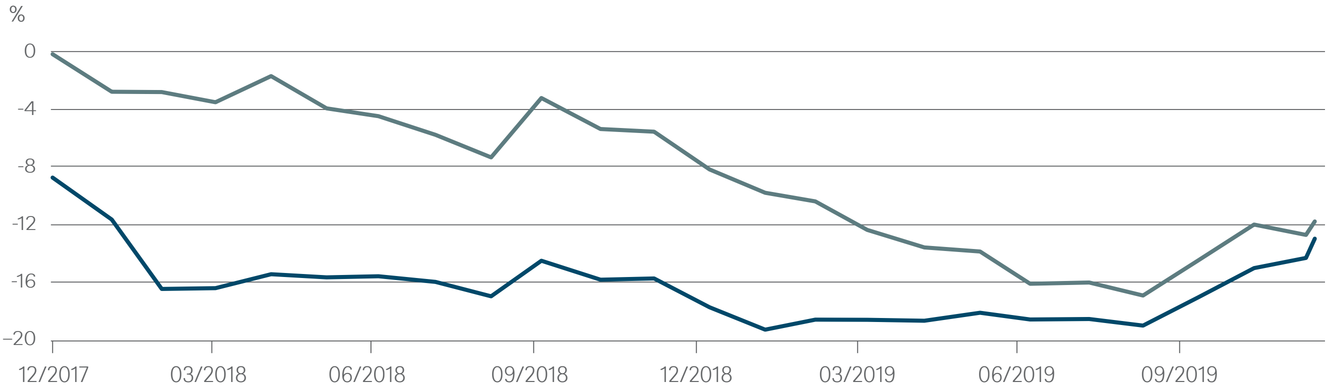
The economic backdrop in Europe appears to be stabilizing. In the third quarter, even trade-dependent Germany has narrowly avoided slipping into recession. Meanwhile, the snap election in the UK on December 12 might finally deliver some Brexit clarity. That said, we think that another hung parliament remains the most likely outcome. So it could still take a while for the Brexit saga to conclude and for pent-up investment demand in the UK and among its European partners to finally resume.



* Our assessment is relative to the MSCI AC World Index, the last quarter's view is shown in parentheses.
Sources: FactSet Research Systems Inc., DWS Investment GmbH as of 12/4/19

JAPAN: NEUTRAL (NEUTRAL)*

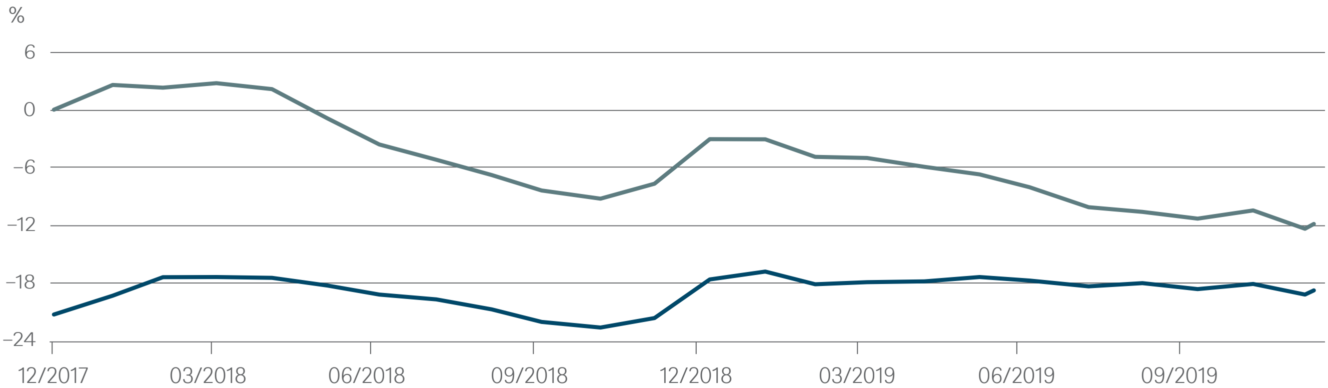
We think that Japanese equities remain fundamentally attractive, due to strong balance sheets, low leverage, improving returns and a stable political environment. Unfortunately, they still lack any obvious triggers for a re-rating over the next couple of months. That would probably require signs of an earnings recovery. In the meantime, trade tensions continue to take their toll and a mere truce in the conflict between the U.S. and China may not be sufficient to provide a sustained boost.



Relative valuation (P/E ratio): MSCI Japan Index vs. MSCI AC World Index
Relative performance: MSCI Japan Index (in yen) vs. MSCI AC World Index (in local currency)

EMERGING MARKETS: NEUTRAL (NEUTRAL)*

Emerging markets have underperformed developed markets in the year to date. That is one of the reasons why we think that emerging-market equities should deliver pretty solid returns in 2020, compared to industrialized countries. However, differentiation at the country level remains key, not the least in light of idiosyncratic political risks and opportunities. With the U.S. Federal Reserve likely to remain on hold, moreover, the tailwind from lower U.S. interest rates might start to fade.



Relative valuation (P/E ratio): MSCI Emerging Markets Index vs. MSCI AC World Index
Relative performance: MSCI Emerging Markets Index (in dollars) vs. MSCI AC World Index (in local currency)

* Our assessment is relative to the MSCI AC World Index, the last quarter's view is shown in parentheses.
Sources: FactSet Research Systems Inc., DWS Investment GmbH as of 12/4/19

GLOSSARY

Brexit is a combination of the words "Britain" and "Exit" and describes the exit of the United Kingdom of the European Union.

A correction is a decline in stock market prices.

The Dax is a blue-chip stock-market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange.

The Democratic Party (Democrats) is one of the two political parties in the United States. It is generally to the left of its main rival, the Republican Party.

Earnings per share (EPS) is calculated as a company's net income minus dividends of preferred stock, all divided by the total number of shares outstanding.

The Electoral College is the body which elects the President and the Vice President of the United States. It is composed of electors from each state equal to that state's representation in Congress.

Emerging markets (EM) are economies not yet fully developed in terms of, amongst others, market efficiency and liquidity.

The European Central Bank (ECB) is the central bank for the Eurozone.

The Eurozone is formed of 19 European Union member states that have adopted the euro as their common currency and sole legal tender.

Growth stocks are stocks from companies that are expected to grow significantly above market average for a certain period of time.

The United States House of Representatives is a legislative chamber consisting of 435 Representatives, as well as non-voting delegates from Washington, D.C. and U.S. territories. Representatives are elected for two-year terms and each state's representation is based on population as measured in the previous Census.

Leverage attempts to boost gains when investing through the use of borrowing to purchase assets.

The MSCI AC World Index captures large- and mid-cap companies across 23 developed- and 24 emerging-market countries.

The MSCI Emerging Markets Index captures large- and mid-cap representation across 23 emerging-market countries.

The MSCI Japan Index is designed to measure the performance of the large- and mid-cap segments of the Japanese market.

The price-to-earnings (P/E) ratio compares a company's current share price to its earnings per share.

A recession is, technically, when an economy contracts for two successive quarters but is often used in a looser way to indicate declining output.

The Republican Party (Republicans), also referred to as Grand Old Party (GOP), is one of the two major political parties in the United States. It is generally to the right of its main rival, the Democratic Party.

The S&P 500 is an index that includes 500 leading U.S. companies capturing approximately 80% coverage of available U.S. market capitalization.

The Stoxx Europe 600 is an index representing the performance of 600 listed companies across 18 European countries.

The U.S. Federal Reserve, often referred to as "the Fed", is the central bank of the United States.

The United States Congress is the legislature of the federal government. It is comprised of the Senate and the House of Representatives, consisting of 435 Representatives and 100 Senators.

The United States Senate is a legislative chamber consisting of 100 Senators, with each state being represented by two Senators. Senators are elected for six year, overlapping terms in their respective state.

Value stocks are stocks from companies that are trading at prices close to their book value and that are therefore cheaper than the market average on that metric.

Volatility is the degree of variation of a trading-price series over time. It can be used as a measure of an asset's risk.

The White House is the official residence and principal workplace of the President of the United States.

PERFORMANCE / Overview

Performance in the past 12-month periods (in %)

	11/14 – 11/15	11/15 – 11/16	11/16 – 11/17	11/17 – 11/18	11/18 – 11/19
Dax	14.0%	–6.5%	22.4%	–13.6%	17.6%
MSCI AC World Index	–1.9%	4.3%	25.3%	–0.4%	14.3%
MSCI Emerging Market Index	–17.0%	8.5%	32.8%	-9.1%	7.3%
MSCI Japan Index	7.6%	1.7%	24.3%	–6.0%	9.3%
S&P 500	2.7%	8.1%	22.9%	6.3%	16.1%
Stoxx Europe 600	14.5%	–8.1%	16.8%	–4.4%	18.3%

Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 12/6/19.

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